



New Issue: Honolulu (City & County of) HI

MOODY'S ASSIGNS Aa3 RATING AND STABLE OUTLOOK TO HONOLULU, HAWAII GENERAL OBLIGATION BONDS

Approximately \$1.46 Billion of Debt Affected

Municipality
HI

Moody's Rating

ISSUE	RATING
General Obligation Bonds, Series 2001A and B	Aa3
Sale Amount	\$150,000,000
Expected Sale Date	02/27/01
Rating Description	General Obligation Bonds

Opinion

NEW YORK, Feb 22, 2001 -- Moody's has assigned an Aa3 rating with a stable outlook to the City and County of Honolulu's General Obligation Bonds, Series 2001 and has affirmed the Aa3 rating on the city's \$1.46 billion of outstanding parity bonds. The current offering is secured by the city's full faith and credit including an unlimited property tax pledge. Proceeds will be used to finance a variety of projects included in Honolulu's capital improvement plan. The Aa3 rating is based primarily on a rebounding state and local economy following a prolonged period of deep recession, sound financial operations which have been strained in recent years but show signs of stabilizing, and manageable debt levels despite frequent borrowing and recent declines in assessed value. The stable rating outlook is based on Moody's expectation that Honolulu's economy will perform relatively well in the near term and that the city will continue to face some budgetary pressures until meaningful and sustainable revenue growth is achieved.

REBOUNING ECONOMY BENEFITS FROM GROWTH IN MAINLAND TOURISM TRAFFIC AND RELATED PUBLIC AND PRIVATE FIXED INVESTMENT; MILITARY PRESENCE PROVIDES STABILITY

Moody's believes that economic activity in Honolulu should remain stable in the near-term based on the city's rebounding tourism sector, overall employment stability on Oahu, improving real estate values, and the substantial volume of public and private investment currently under way.

A vital component of Honolulu's, and the state's, economic turnaround is the rebound of the tourist-dependent economy despite the stagnant Japanese tourist market - historically key to Hawaii tourism. In recent years, Honolulu's tourism sector suffered lackluster performance characterized primarily by sharp declines in eastbound (Asian) travelers, offset in part by increased traffic from westbound (mostly mainland US) tourists who, on average, spend only about half of what Asian visitors spend while in the islands. The weakness in eastbound visitor totals is directly attributable to the underperformance of the Japanese economy. As Asian visitor counts have recently stabilized, ongoing growth in westbound travelers, primarily from California, will continue to be an important factor in the overall health of the Hawaiian tourism industry. Still positive economic prospects for California bode well for the Hawaiian tourism industry as the US-West market (which is dominated by California) represented more than one-third of total visitors in 1999, and 30% of total visitor spending. While California's recent energy crisis, if it persists, could damage its own economy and reputation, Moody's believes that California's economic fundamentals are strong enough to sustain at least near-term continuation of visitor growth in Hawaii.

The strong performance of the tourism industry in 1999 and 2000 has spurred increased private fixed investment in the state, reversing a trend of negative or flat growth since 1991 and generating new jobs on Oahu and throughout the state. Hotel room occupancy rates have risen to pre-1990 levels, encouraging large hotel owners to renew efforts to expand and upgrade their properties on the islands. On Oahu alone, about \$1 billion of public and private construction projects are either in progress or have recently been completed. Major projects include a 750-unit, \$300 million Marriott Hotel at Ko Olina, a \$135 million retail mall in Waikiki, and a \$95 million hotel tower at the Hilton Hawaiian Village. Moody's believes that such investment should help sustain economic activity on Oahu in the form of employment and tax base growth in the near-term even if tourism slows unexpectedly due to a softening US mainland economy.

Federal defense spending in Hawaii plays a large part in the state's economy, with an estimated 96% of military personnel stationed on Oahu. Military and civilian federal jobs comprise 17% of the state's employment base, down from a peak of 21% due to the federal government's efforts to downsize a number of its military installations. Such downsizing efforts have concluded in Hawaii, however, and Moody's believes the defense presence will continue to provide a stable source of employment and income given the state's crucial strategic geographic location.

TAX BASE SHOWS SIGNS OF REBOUNDED FOLLOWING SIX CONSECUTIVE YEARS OF DECLINES; REAL ESTATE VALUES ARE RISING

Following a period of rapid escalation in property values in the late 1980s and early 1990s Honolulu's tax base experienced significant erosion from 1996 through 2001, losing almost one-fifth of its value during that period. However, preliminary assessed value figures for fiscal 2002 indicate a long-awaited turnaround of this negative trend with assessed value growth in Honolulu estimated at 1.4%. Perhaps more important than this relatively small rate of growth is the expectation that positive growth will continue in the near term given the lag between real estate prices and assessed valuation. The fact that, by some measures, residential real estate values on Oahu have been rising since 1999 clearly bodes well for the city's assessed valuation trend over the next couple of years. An additional strength is that the current real estate market shows no signs of the type of speculative bubble which occurred in the early 1990s.

It is also noteworthy that Honolulu's preliminary assessed valuation figures for fiscal 2002 exceed an impressive \$80,000 per capita and point to an unusually wealthy tax base. In addition to high land costs, attributable to being a densely populated island, the large tax base is also reflective of the strengths of the economy and the tourism presence in particular. Despite the moderating influence of many tourism-related service jobs, income levels exceed national averages with the city's per capita income of \$28,670 in 1998 representing 105% of the national average. Median housing values in Honolulu are more than three-and-a-half times the national median.

IMPROVING REVENUE PICTURE SHOULD ENHANCE FINANCIAL FLEXIBILITY, THOUGH BUDGETARY PRESSURES LIKELY TO PERSIST IN THE NEAR TERM

Although the city's financial flexibility has eroded in recent years, as evidenced by the repeated use of one-time gap closing actions, management's commitment to maintaining budget balance and improving reserves has been increasingly evident and continues to be an important factor in Moody's credit evaluation of Honolulu. Unaudited financial results for fiscal 2000 indicate the second consecutive year of General Fund operating surpluses following a prolonged period of financial deterioration which ended in fiscal 1998 when reserves dipped to a relatively thin 5.8% of General Fund revenues. Despite continued declines in assessed valuation, fiscal year 1999 results were positive, with an increase in fund balance to 7.4% of revenues due primarily to a combination of tax rate increases and continuation of spending controls. Unaudited fiscal 2000 results point to another slight increase in reserve levels to a satisfactory 9.2% of General Fund revenues. Including a new \$5 million rainy day fund, officials anticipate that fiscal 2001 will roughly mirror fiscal 2000 results, with year-end reserves totaling approximately 9% to 10% of revenues.

Prior year assessed valuation declines were particularly significant to the city's credit profile in that property tax revenues represent approximately two-thirds of operating revenues. Management addressed the impact of the city's declining tax base on financial operations by raising tax rates. While management's strategy was successful in generating a steady level of property tax revenues, the lack of growth to the city's most dominant revenue component still resulted in a strained budget environment. For example, budget shortfalls of between \$50 million and \$130 million annually have been typical since fiscal 1996. Management addressed these budget shortfalls through a variety of cost cutting measures such as workforce reductions, department consolidations, hiring freezes and achieving self-support for enterprise activities. At the same time, however, the city relied on a number of one-time budget-balancing actions including a large debt restructuring in March 1999. This debt restructuring produced only minimal present value savings and was primarily driven by a need to generate budget savings further indicating limited financial flexibility.

Going forward, Moody's believes that the city's financial position should continue to improve as it benefits from a combination of growing tax revenues and the ongoing savings associated with structural spending reforms implemented in recent years. Nevertheless, it remains likely that Honolulu will continue to face its share of budget challenges in the near term. Although the fiscal 2002 budget proposal is not yet available, officials have preliminarily acknowledged a moderate budget shortfall which could rely on certain one-time gap closing actions including new utility tax revenues which had previously gone to the state (required legislation is expected to pass in April), a residual equity transfer from the Sewer Fund for prior investment made by the General Fund, and potential additional debt restructuring. Key expense items contributing to the preliminary 2002 budget gap include an increase in the employer pension contribution and salary increases scheduled under the current collective bargaining agreement. Despite these ongoing budget issues, Moody's believes that the city's demonstrated ability to manage its finances well under difficult circumstances bodes well for future financial stability, especially in light anticipated revenue growth.

DEBT LEVELS EXPECTED TO REMAIN MANAGEABLE; REASONABLE BORROWING PLANS AND EXPECTED TAX BASE GROWTH SHOULD FURTHER MODERATE DEBT LEVELS

Moody's expects that Honolulu's debt levels will continue to remain manageable, despite past tax base losses, given reasonable borrowing assumptions and the expectation of moderate tax base growth in the near term. Also, management has begun to fund the construction activities of various enterprise systems out of system rates rather than through property taxes. As a result, future borrowings will emphasize revenue rather than general obligation issuances. In addition, Honolulu's debt levels will remain manageable given the active role the state government plays in financing the capital needs for municipal activities more typically funded at the local level throughout the rest of the country including transportation, health, justice, and education.

Debt burden measures compare favorably to other cities and counties in the United States with overall debt (inclusive of reimbursable General Obligation Bonds) representing only 1.7% of fiscal 2002 taxable values. Including the current offering, the city has approximately \$1.46 billion of outstanding general obligation bonds and about \$554 million of remaining unissued authorization.

Outlook

The rating outlook for Honolulu is stable. Its highly tourist-dependent economy will continue to rely on the strength of the US economy, as a Japanese recovery is not anticipated. The increased level of private investment is likely to continue in the near term and should help stimulate job growth and assessed value gains for the foreseeable future. Budget pressures, while moderating, will likely persist until meaningful and sustainable revenue growth is achieved.

KEY STATISTICS:

1999 population: 864,571

1990 per capita income: \$16,256 (103% of state)

1990 median housing value as % of state median: 105%

2001 full valuation: \$68.7 billion

2002 full valuation (preliminary): \$69.7 billion

Direct and overall debt burden: 1.7%

Payout of principal, 10 years: 49.0%

FY 2000 total General Fund balance (unaudited): \$58.9 million (9.2% of General Fund revenues)

Analysts

Matthew Jones
Analyst
Public Finance Group
Moody's Investors Service

Kenneth Kurtz
Backup Analyst
Public Finance Group
Moody's Investors Service

Steven Levine
Director
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1625